Charitable Deduction - Corpus ?

Supreme Court, U. S.
FILED
SEP 3 1954
HAROLD B. WILLEY, Clerk

No. — [redacted] 24

In the Supreme Court of the United States

OCTOBER TERM, 1953

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF LOUIS STERNBERGER, THE CHASE NATIONAL BANK OF THE CITY OF NEW YORK, EXECUTOR

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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The Acting Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Court of Appeals for the Second Circuit entered in this case.

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 2-11) are reported at 18 T.C. 836. The *per curiam* opinion of the Court of Appeals (R. 66) is reported at 207 F. 2d 600.

JURISDICTION

The judgment of the Court of Appeals was entered on November 6, 1953. (R. 67.) The juris-

diction of this Court is invoked under 28 U.S.C. Section 1254.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's holding that the decedent's estate is entitled to a charitable bequest deduction under Section 812 (d) of the Internal Revenue Code for contingent remainders to designated charities under which the charities will take only if the decedent's daughter (age 27 at the decedent's death) dies without leaving issue or other descendants surviving her and her mother.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 812. NET ESTATE.
>
> For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—
>
> * * * * *
>
> (d) *Transfers for Public, Charitable, and Religious Uses.*—The amount of all bequests, legacies, devises, or transfers * * * to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, * * *.
> (26 U.S.C. 1946 ed., Sec. 812.)

Treasury Regulations 105, promulgated under the Internal Revenue Code:

SEC. 81.44 *Transfers for public, charitable, religious, etc., uses.*—* * *

If a trust is created for both a charitable and a private purpose, deduction may be taken of the value of the beneficial interest in favor of the former only insofar as such interest is presently ascertainable, and hence severable from the interest in favor of the private use. Section 81.10 indicates the principles to be applied in the computation of the present worth of deferred uses, but such computation will not be made by the Commissioner on behalf of the executor. Thus, if money or property is placed in trust to pay the income to an individual during his life, or for a term of years, and then to pay or deliver the principal to the charitable corporation, or to apply it to a charitable purpose, the present value of the remainder is deductible. To determine the present value of such remainder, use the appropriate factor in column 3 of Table A or B of section 81.10. If the present worth of a remainder bequeathed for a charitable use is dependent upon the termination of more than one life, or in any other manner rendering inapplicable Table A or B of section 81.10, the claim for the deduction must be supported by a full statement, in duplicate, of the computation of the present worth made, in accordance with the principle set forth in section 81.10, by one skilled in actuarial computations.

* * * * *

SEC. 81.46 *Conditional bequests.*—If as of the date of decedent's death the transfer to charity is dependent upon the performance of some act or the happening of a precedent event in order that it might become effective, no deduction is allowable unless the possibility that charity will not take is so remote as to be negligible. If an estate or interest has passed to or is vested in charity at the time of decedent's death and such right or interest would be defeated by the performance of some act or the happening of some event which appeared to have been highly improbable at the time of decedent's death, the deduction is allowable.

If the legatee, devisee, donee, or trustee is empowered to divert the property or fund, in whole or in part, to a use or purpose which would have rendered it, to the extent that it is subject to such power, not deductible had it been directly so bequeathed, devised, or given by the decedent, deduction will be limited to that portion, if any, of the property or fund which is exempt from an exercise of such power.

STATEMENT

The facts found by the Tax Court (R. 4-8) may be summarized as follows:

Louis Sternberger, the decedent, died on June 25, 1947. The executors of his estate filed a federal estate tax return disclosing a gross estate of $2,406,541.71. The gross estate consisted of certain assets which the decedent owned at the date of his death and other assets held in a revocable trust he had

created on January 20, 1931, of which he was the primary life beneficiary. In the estate tax return, the executors claimed the amount of $179,154.19 as a charitable deduction representing the alleged value of contingent charitable remainders provided for in the decedent's will and in the *inter vivos* trust of January 20, 1931. (R. 4-6.)

As of the date of the decedent's death, the dispositive provisions of the *inter vivos* trust (after a specific bequest of $5,000) were in all respects identical with the dispositive provisions of the residuary clause of the decedent's will. (R. 5.)

The will provided that the decedent's residuary estate is to be held in trust during the joint lives of the decedent's wife, Eunice E. Sternberger, and his daughter, Eunice P. Sternberger, and the survivor of them and, upon the death of the survivor, the principal is to be paid in equal shares to "the descendants then living" of his daughter, *per stirpes*, and, in the event there are none such, one-half to certain collateral relatives of the decedent then living and one-half to certain charitable organizations. In the event no collateral relatives are then living, the entire principal is to be paid to the charitable organizations. (R. 5.)

The decedent's wife survived him and was 62 years of age at the date of his death. The decedent's daughter also survived him and was 27 years of age at the date of his death. She had been previously married and was divorced on March 31, 1944. At the date of the decedent's death, she was unmarried and had had no children. (R. 6.)

At the Tax Court hearing, the executors of the decedent's estate introduced actuarial evidence designed to show the value of the contingent charitable remainders as of the decedent's death. This evidence related to computations based upon (1) the joint life expectancy of the decedent's wife and daughter, as determined from mortality tables, (2) the probability of the daughter remarrying, as determined from the American Remarriage Table published by the Casualty Actuary Society, and (3) the probability of a child being born to the decedent's daughter, as determined from a table prepared by one of the testifying actuaries in accordance with accepted actuarial principles based upon data taken from the 1940 census. In making the computations, it was assumed that, if the decedent's daughter married and became the mother of a child, the child would survive her. It was also assumed that there would be someone in the group of collateral relatives who would be living at the deaths of the decedent's wife and daughter, so that not more than 50 per cent of the principal of the trusts would pass to the named charitable organizations. The computations resulted in a figure of $.24094 per dollar of trust corpus based on legitimate descendants of the daughter and of $.24058 including illegitimates. (R. 6-8.)

The Tax Court held that the decedent's estate is entitled to a deduction under Section 812 (d) of the Internal Revenue Code for the contingent remainders to charity. Decision was based, first, upon an assumption that Section 812 (d) allows a deduction

for contingent remainders and secondly, upon an acceptance of the actuarial computation of $.24058 per dollar of trust corpus as a reliable estimate of the value of the contingent remainders as of the decedent's death. (R. 8-11.) The Court of Appeals affirmed the Tax Court "on the authority of *Meierhof* v. *Higgins*, 129 Fed. (2) 1002 (C. A. 2)." (R. 66.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In allowing a deduction under Section 812 (d) of the Internal Revenue Code for a charitable bequest which was wholly contingent as of the decedent's death.

2. In failing to apply Section 81.46 of Treasury Regulations 105, which provides that no deduction is allowable under Section 812 (d) for a conditional charitable bequest under which the possibility that the charities will not take is not so remote as to be negligible.

3. In premising deductibility under Section 812 (d) on an actuarial computation which merely reflected the charities' chances of taking all or nothing and which was nothing more than a guess even as to the value of the charities' contingent interest.

REASONS FOR GRANTING THE WRIT

1. The decision below, holding that the actuarial value of a contingent charitable remainder is deductible under Section 812 (d) of the Internal Revenue Code, *supra*, p. 2, is squarely in conflict with the decision of the First Circuit in *Newton Trust*

Co. v. *Commissioner*, 160 F. 2d 175. That case (pp. 180-182) presented a situation which, because it involved a contingent power of invasion, was treated as equivalent to a trust to pay the income to A for life and upon the death of A remainder to B, if B survives A, and if B does not survive A then over to charity. Since A and B were the same age and their life expectancy was the same, the taxpayer contended that the value of the contingent remainder to charity could be actuarially computed by using a 50 per cent factor. The Court of Appeals for the First Circuit stated that it did not question the correctness of the taxpayer's actuarial computation nor its use in other situations (pp. 180-181) but that there was no certainty that the charity would take 50 per cent of the trust corpus, but rather that the charity had a fifty-fifty chance of getting all or nothing. The Court of Appeals accordingly denied the claimed deduction because there was an even chance that the charity would not take and Section 81.46 of Treasury Regulations 105, *supra*, p. 4, entitled "Conditional bequests", provides that no deduction is allowable for a conditional bequest unless the possibility that the charity will not take is so remote as to be negligible.

In the present case, the contingent charitable remainders were conditioned upon the failure of the decedent's daughter (who was 27 years of age at the decedent's death) to leave issue surviving her and her mother. The acturial computation of the value of the contingent charitable remainders was

her mother, the probability that the daughter would remarry, and the probability that she would have issue. The result was a figure of $.24058 per dollar of trust corpus (including illegitimates) which of course did not represent what the charities were certain to receive. It was a "percentage figure" (R. 26) representing the charities' chances of taking all or nothing, showing that there was a three-to-one chance that the charities would *not* take anything. This, of course, was not a possibility so remote as to be negligible. Instead of applying Section 81.46 of Treasury Regulation 105, as it was requested to do, the court below affirmed "on the authority of *Meierhof* v. *Higgins*, 129 Fed. (2) 1002 (C. A. 2)" (R. 66), in which it had disregarded the then applicable regulation entitled "Conditional bequests" and held that a contingent bequest to charity is deductible if it has a market value. The result is a decision in direct conflict with the decision of the First Circuit in the *Newton Trust Co.* case.[1]

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[1] Ever since Congress first authorized the deduction of charitable bequests in Section 403(a)(3) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, the pertinent Treasury Regulations have contained an article entitled "Conditional bequests" which in effect provided that no deduction is allowable for a bequest which is conditional as of the decedent's death. See Article 56 of Treasury Regulations 37 (Revised, 1919, and Revised January, 1921, eds.), promulgated under the Revenue Act of 1918; Article 50 of Treasury Regulations 63, promulgated under the Revenue Act of 1921; Article 47 of Treasury Regulations 68, promulgated under the Revenue Act of 1924, of Treasury Regulations 70 (1926 and 1929 eds.), promulgated under the Revenue Act of 1926, and of Treasury Regulations 80 (1934 and 1937 eds.), promulgated under the Revenue Acts of 1926 and 1932, as amended; and Article 81.46 of Treasury Regulations 105. In *Meierhof* v. *Higgins*, 129 F. 2d 1002 (C. A.

2. The decision below is also in conflict with *Humes* v. *United States*, 276 U. S. 487, and decisions which have interpreted and applied it. The *Humes* case involved the deductibility of a contingent charitable bequest under which the charities would take a trust remainder if the decedent's niece (15 years of age and unmarried at the decedent's death) should die without issue before attaining the age of 40. In denying the claimed deduction, the Court regarded an actuarial computation of present value as "mere speculation bearing the delusive appearance of accuracy" (p. 494) and held that Congress

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2d), the pertinent regulation was Article 47 of Treasury Regulations 68, which provided in part as follows:

> *Conditional bequests.*—Where the transfer is dependent upon the performance of some act or the happening of some event in order to become effective, it is necessary that the performance of the act or the occurrence of the event shall have taken place before the deduction can be allowed.

In the *Meierhof* case the Second Circuit held (p. 1005) that this language was not controlling, stating that it should be read in connection with quoted provisions of Article 44 (which are presently contained in Article 81.44 of Treasury Regulations 105, *supra*, p. 3, relating to trusts created for both a charitable and private purpose), and went on to hold that a contingent charitable bequest is deductible if it has a market value. Subsequently, this Court decided *Merchants Bank* v. *Commissioner*, 320 U. S. 256, in which the Court clearly indicated that the regulation covering conditional bequests must be given effect and that the regulation covering trusts created for both a charitable and a private purpose has reference only, for example, to a trust under which the income is payable to an individual for life and the remainders to charity. In the present case we relied upon the present regulation covering "Conditional bequests" (Section 81.46 of Treasury Regulations 105) in both the Tax Court, where, however, we merely quoted the regulation, and in the court below, where we in detail pointed out all of the above in our brief. The court below nevertheless decided the case on the authority of its *Meierhof* decision.

did not intend to allow a deduction for a contingent bequest whose value could only be guessed at. In *Ithaca Trust Co.* v. *United States*, 279 U. S. 151, which involved the deductibility of a charitable bequest of trust corpus subject to invasion for the benefit of the life tenant, the *Humes* decision was cited (p. 154) for a statement that the question was whether the power of invasion made the gifts to charity "so uncertain" that deduction for the charitable remainder could not be allowed. In *United States* v. *Provident Trust Co.*, 291 U. S. 272, deduction was allowed for a contingent charitable remainder only because the contingency on which the charities' right to take was, as a practical matter, non-existent.[2] Following these decisions, and in contrast to the court below, several Courts of Appeals have held, with or without reference to the pertinent Treasury Regulations, that conditional

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[2] The *Provident Trust Co.* case involved the deductibility of the value of a contingent remainder under which charities would take if the decedent's daughter died without issue. At the decedent's death the daughter was 50 years of age, had no issue, and had had an operation which rendered her incapable of giving birth to a child. In contending that the value of the remainder was not deductible, the Government relied upon the restriction in respect of issue, arguing that a woman is presumed to be capable of bearing children as long as she lives. The Court allowed the deduction, holding that the presumption was open to rebuttal and that (p. 286)—

> the birth of a child to the daughter of the deceased after his death was so plainly impossible that, as a practical matter, the hazard disappears from the problem. • • •

The present Treasury regulation covering "Conditional bequests" recognizes that the deduction is allowable in such a case by providing for allowance of the deduction when the happening of the event constituting the contingency is highly improbable.

charitable bequests are not deductible under Section 812 (d) of the Code or its identical predecessors. See, e.g., *Helvering* v. *Union Trust Co.*, 125 F. 2d 401, 403 (C. A. 4th), certiorari denied, 316 U. S. 696; *Norris* v. *Commissioner*, 134 F. 2d 796 (C. A. 7th), certiorari denied, 320 U. S. 756; *Knoernschild* v. *Commissioner*, 97 F. 2d 213 (C. A. 7th); *First Trust Co. of St. Paul State Bank* v. *Reynolds*, 137 F. 2d 518 (C. A. 8th); *Mississippi Valley Trust Co.* v. *Commissioner*, 72 F. 2d 197 (C. A. 8th), certiorari denied, 293 U. S. 604; *United States* v. *Fourth Nat. Bank in Wichita, Kan.*, 83 F. 2d 85 (C. A. 10th), certiorari denied, 299 U. S. 575.

3. In allowing a deduction for a contingent charitable bequest, the decision below is also in conflict in principle with this Court's decision in *Merchants Bank* v. *Commissioner*, 320 U. S. 256, and in *Henslee* v. *Union Planters Bank*, 335 U. S. 595. The *Merchants Bank* case involved the deductibility of a charitable remainder of trust corpus which was subject to invasion for the "comfort, support, maintenance, and/or happiness" of the decedent's wife, the life tenant. (P. 258.) The charitable bequest was thus conditional in the sense that the charities had a right to receive only the corpus not used by the decedent's wife. The case was accordingly covered by the second paragraph of the applicable Treasury regulation entitled "Conditional bequests", which was identical to the second paragraph of the present Section 81.46 of Treasury Regulations 105. In denying the claimed deduction, the Court stated that for the deduction to be allowed

Congress and the Treasury require that a highly reliable appraisal "of the amount the charity will receive" be available and made at the death of the testator and that rough guesses, approximations, and even market value are not sufficient. (P. 261.) The deduction was denied because the possibility of use of the trust corpus by the decedent's wife introduced a contingency which made it impossible to determine accurately what the charity would ultimately receive. *Henslee* v. *Union Planters Bank*, *supra*, was a similar case in which, as the Court stated (p. 599), contingent remainders to charity could be "diminished or destroyed" by a power of invasion. The Court referred to "the test of present ascertainability of the *ultimate* charitable interest" (italics supplied) (p. 600) and stated that the contingency which would have diminished or destroyed the charitable interest might well have been insured against "but such an arithmetic generalization of experience would not have made this charitable interest 'presently ascertainable' " (p. 599) —that though there was little chance that the charitable remainder would be diminished or destroyed, the fact that the chance remained precluded the deduction. These two cases therefore stand for the proposition that the deduction is allowed only for the present value of what the charities are certain to receive in the future (with such slight variation as is allowed by *Ithaca Trust Co.* v. *United States*, 279 U. S. 151), not, as the court below held, for the present value of a contingent interest representing only a possibility of receipt.

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be granted.

Respectfully submitted,

ROBERT L. STERN,
Acting Solicitor General.

FEBRUARY, 1954.

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